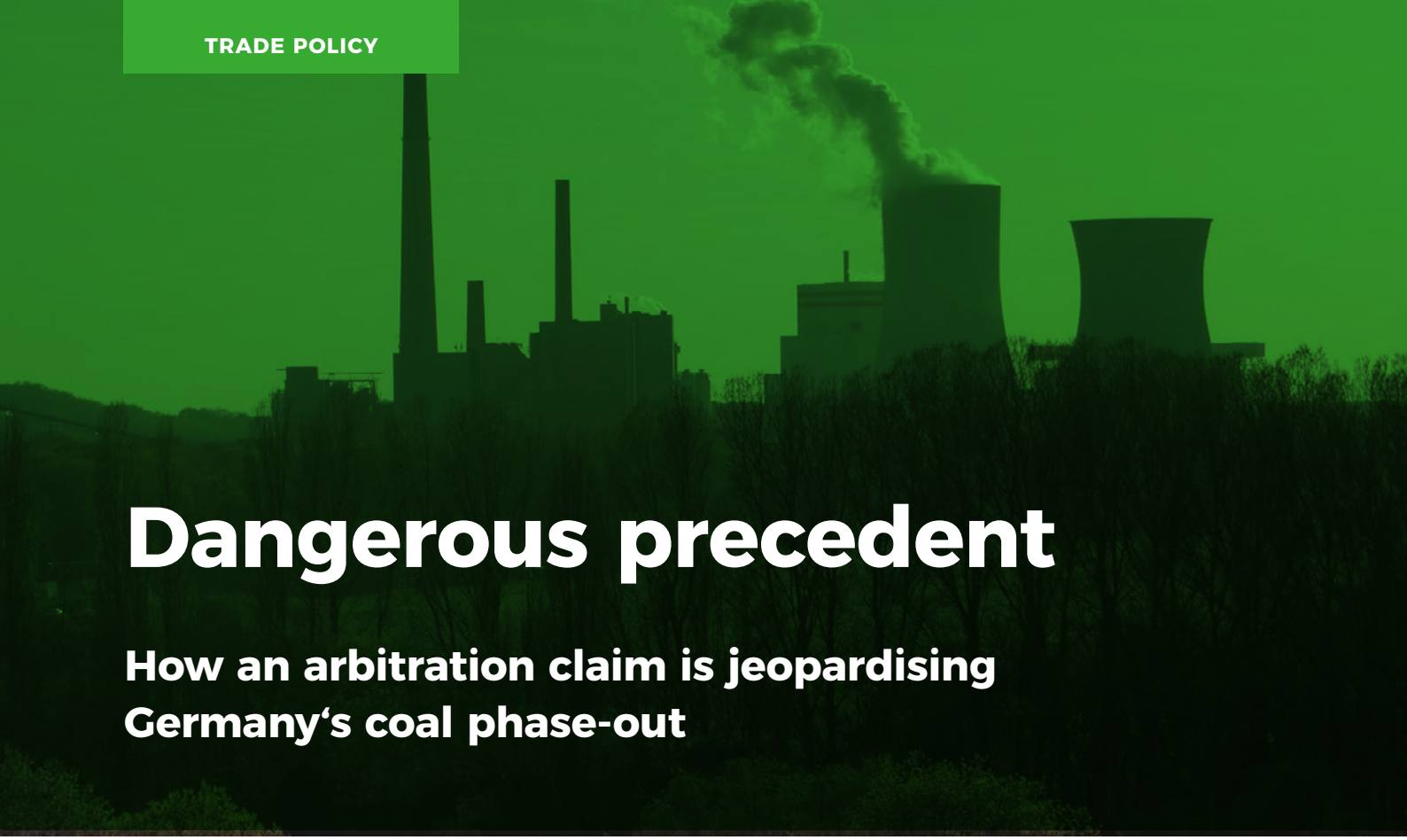
TRADE POLICY



Dangerous precedent

How an arbitration claim is jeopardising Germany‘s coal phase-out

A Swiss public company, Azienda Elettrica Ticinese (AET), is demanding compensation in an international arbitration tribunal for Germany‘s coal phase-out. The company holds shares in a German coal-fired power plant that will cease operations due to the phase-out. The case is an example of ongoing and problematic attempts to make the public pay for bad fossil fuel investments by deploying a one-sided arbitration mechanism.

→ In a campaign against AET‘s involvement in the coal-fired power plant, civil society organisations highlighted the economic risks of the project. These concerns were ignored by AET – and then materialised once the power plant went into operation. The power plant has incurred losses every year since its construction. AET is thus demanding compensation for a plant that has been loss-making and is expected to remain so, despite having been warned of this potential outcome of its investment.

→ In the arbitration proceedings, AET is demanding compensation for its hypothetical revenues from the power plant until 2053. However, the results of a Swiss referendum meant that AET was anyway obliged to withdraw from its investment in the plant by 2035 at the latest. In addition, European coal-fired power plants are currently expected to wind up operations as early as the 2030s, due to the rising price of emission certificates. Through the arbitration, AET is attempting to claim profits that it would clearly never have been able to generate in reality.

→ If AET succeeds in the proceedings, the architecture of the German coal phase-out will be called into question, and this could lead to further challenges from coal companies in arbitration tribunals. It is an example of the danger that international arbitration tribunal cases pose to the much-needed ongoing energy transition, and to public budgets.

It is imperative that countries like Germany and Switzerland withdraw from investment protection agreements that enable cases like AET‘s. This is the only way to eliminate the considerable risks to climate policy and public coffers posed by arbitration tribunals.

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Introduction: Climate protection in the dock

In October 2023, Azienda Elettrica Ticinese (AET) filed an arbitration claim under the Energy Charter Treaty (see box 1) against the Federal Republic of Germany. Since March 2024, a tribunal of three private arbitrators has been considering the case. It will decide whether AET must be compensated by German taxpayers for Germany's coal phase-out. What makes this case particularly controversial is the fact that a Swiss state-owned company is taking action against a central component of Germany's move away from fossil fuel power generation. If the claim is successful, it would set a dangerous precedent that could encourage other companies to undermine the coal phase-out in Germany and other countries. This policy brief explains the background to the claim, and why investment arbitration is so dangerous for the energy transition.

Controversial involvement in a disputed coal-fired power plant project

Azienda Elettrica Ticinese is a Swiss energy company, fully owned by the Canton of Ticino. It operates a number of hydroelectric power plants and solar parks in Switzerland. Internationally, it is only involved in a few projects, including a single coal-fired power plant: the Trianel plant in Lünen, North Rhine-Westphalia. The power plant was commissioned in 2013 after a four-year construction period. AET owns just under 16% – the remaining shares are held by German municipal utilities (79%) and Salzburg AG from Austria (5%).

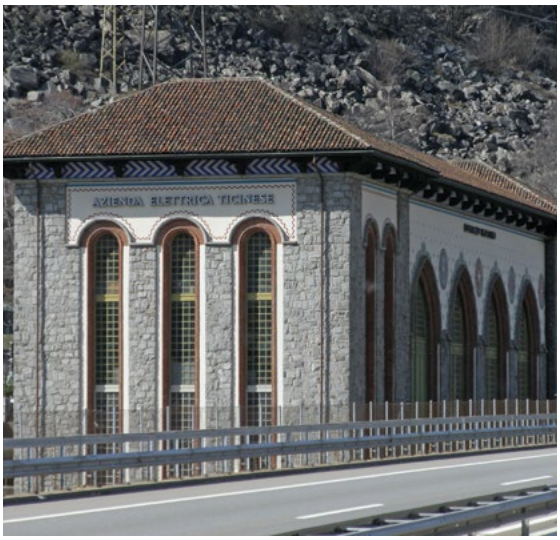
The construction of the power plant, and AET's participation in the project, were highly controversial from the outset. Local residents protested against it because of the significant climate and environmental impact. Affected residents also approached AET directly to dissuade the company from investing in the project. The regional branch of Friends of the Earth Germany (BUND) filed several lawsuits against the permits for, and the operation of, the plant. The proceedings were halted in 2023 after the licensing authority once again significantly limited the permitted pollutant emissions from the plant.[1]

Box 1:
Germany and Switzerland in the Energy Charter Treaty

AET's case is being taken under the Energy Charter Treaty (ECT), a multilateral agreement from the 1990s that aimed to protect investors from government interference in the energy sector, and grants them access to private arbitration tribunals. No other treaty has enabled as many arbitration cases by investors against states as the ECT. Germany has already been sued six times under the ECT, including for its nuclear phase-out and for environmental regulations relating to the Hamburg Moorburg coal-fired power plant.

Until a few years ago all EU member states, the EU itself, and a number of countries from Eastern Europe, Western and Central Asia, and Japan were members of the treaty. However, after a disappointing ECT reform process, more than ten countries, including Germany, France, Poland, Spain, the United Kingdom, and the EU itself, decided to withdraw from the treaty. Although a sunset clause allows complaints to be filed for 20 years after withdrawal, this could be significantly mitigated by a supplementary agreement that neutralises the clause among the withdrawing parties.[10]

In contrast to its European neighbours, Switzerland has not yet left the ECT. Investors regularly use subsidiaries in Switzerland to bring arbitration proceedings under the ECT. Nine cases have been launched from Switzerland - all against EU member states and the EU itself. These include a case by the Nord Stream 2 AG, which seeks compensation of up to €8 billion from the EU before an arbitration tribunal for a gas infrastructure regulation.[11]



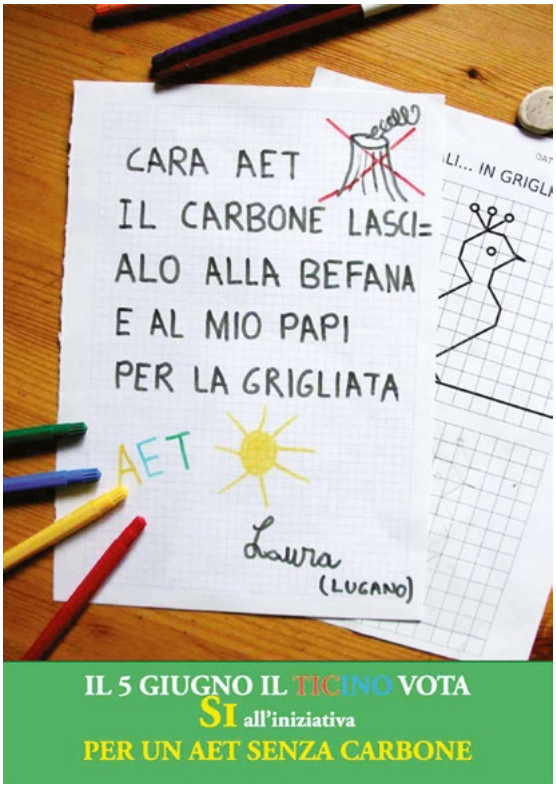
A hydroelectric plant in Ticino owned by AET.
Photo: : Amanda Slater, Wikimedia
CC BY-SA 2.0

In Switzerland, too, there was considerable resistance to the AET's involvement in this large-scale fossil fuel project. Environmental organisations and political parties in Ticino criticised AET's entry into fossil fuel power generation. They campaigned to point out the negative consequences for the climate, the environment and human rights in the coal-mining countries like Colombia that supply the power plant.

The considerable economic uncertainties associated with the investment were also highlighted: a foreseeable increase in the price of CO_2, the falling production costs and expansion of renewable energy, as well as expected energy policy changes in Germany meant enormous risks for the power plant project and thus also for AET, according to opponents of the investment.[2]

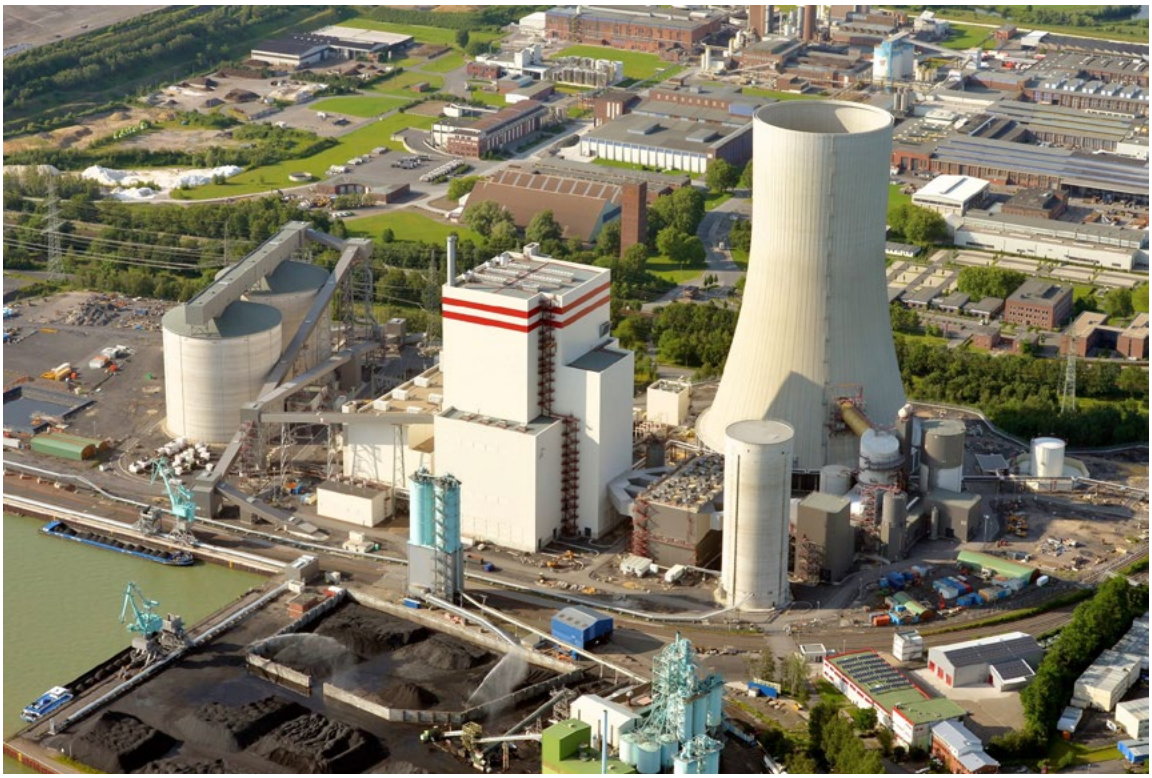
A referendum was organised in Ticino in 2010 against AET's participation in the power plant project in Lünen, and was only narrowly lost by the campaign. A counter-proposal that formed part of the same referendum was put forward by the parties governing the canton, and it narrowly prevailed. It obliges AET to withdraw from the Lünen power plant by 2035 at the latest.[3]

The exit date set by the vote is only four years after the shutdown date set by Germany for its coal phase-out, and long before the end of the supposed 40-year lifespan of the plant. Yet, AET now wants to be compensated for the hypothetical operation of the power station until 2053![4] Thus, according to the alleged operating plan, the power plant is supposed to continue operating for 18 years longer than AET itself is allowed to participate in its operation, due to the referendum outcome.



A flyer used in the campaign against AET's involvement in the coal-fired power plant.

The critics of the AET's participation in the power plant were proven to be right: after the construction costs for the plant almost doubled from 750 million to 1.4 billion euro during the planning phase,[5] the power plant went on to record losses every year since it commenced operating, totalling over 400 million euro.[6] As early as 2015, the opposition in the cantonal parliament lamented the project's lack of economic viability and the financial burden it was placing on the canton and its citizens.[7] Opposition politicians estimate that by now AET alone has incurred a total loss of almost 195 million Swiss francs (203 million euro) from the Lünen project.[8] The audit report for the power plant's 2023 financial statements attributes its ongoing economic problems to factors including the high price of CO_2 and the strong growth of renewable energy, just as critics had predicted.[9]



The Trianel power plant was opened in 2013.
Photo: Rainer Klute, Flickr, CC BY 2.0

Background: Germany‘s coal phase-out

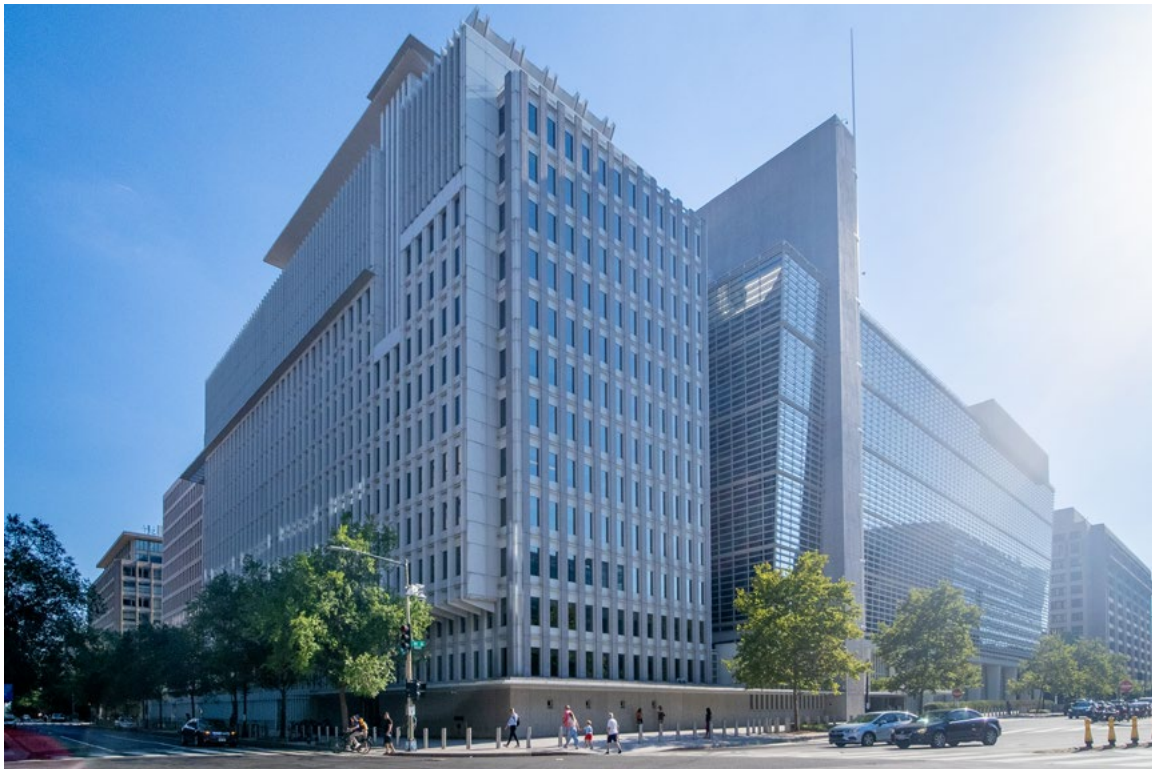
AET‘s complaint is directed against the provisions of Germany‘s coal phase-out act. This law is essential to achieving the climate targets set out in the Paris Agreement and the German Climate Change Act. In 2018, Germany convened the ‘Coal Commission’, a broad-based body that developed proposals for a socially acceptable coal phase-out. In 2019, it recommended a tendering mechanism for the decommissioning of coal-fired power plants.

The Coal Phase-out Act, which was passed in 2020, stipulates that seven voluntary tendering rounds will take place between 2020 and 2026. Power plant operators can submit compensation offers for the decommissioning of their power plants. The maximum price provided will fall each year to create incentives for early participation. Operators who receive an award will have to decommission their plants by a set date, but can also convert them to use alternative fuels such as biomass.

From 2027, plants that have not been decommissioned will be shut down in order of age without compensation. The only exceptions will be if a power plant is needed to ensure security of supply, or in cases of hardship. The tendering model was chosen to achieve cost-effective capacity reductions while at the same time offering operators a transparent chance of compensation.

One example of participation in the tendering mechanism is the Hamburg Moorburg power plant, which opened in 2015 and was shut down just six years later, in 2021, in exchange for compensation.[12] Other operators, such as the consortium that runs the Trianel coal-fired power plant in Lünen, decided against participating in the tenders, and opted for a longer operating life until the plant was legally shut down without compensation.

Subsequent compensation for operators who lost out in the tenders - as AET is seeking through the arbitration process - would call into question the architecture of the German coal phase-out. Germany‘s attempt to design the coal phase-out in line with its climate protection commitments and in a way that is sustainable for public finances could be undermined by the arbitration case. This could lead to significantly higher costs for the public, or a delay in the coal phase-out.



The World Bank in Washington is home to the International Centre for Settlement of Investment Disputes, under whose rules the AET claim will be heard.

Photo: Ajay Sureshm, CC BY 2.0

Unconvincing claims by AET – Fantasy revenues

Despite the compensation and conversion options described above, AET bases its complaint on the lack of compensation provided for the decommissioning of the power plant in Lünen. But the fact is that the potential compensation for the Lünen power plant was not claimed due to business decisions taken by the operating company. No obligation on the part of the state to provide additional compensation can be derived from this.

AET's reasoning for its arbitration case – that it cannot determine Trianel's decisions alone due to its minority shareholding – is not convincing.[13] AET itself made the business decision to acquire a minority share in the power plant and thus not to have sole control over the plant's corporate decisions.

In its submission to the arbitration tribunal, AET demands to be compensated for hypothetical revenues from the power plant had it continued to operate until 2053.[14] This demand is highly problematic from an energy and climate policy perspective. Modelling of European climate policy and emissions trading shows that coal-fired power generation in Europe will end in the early 2030s.[15] In other words, even without a legal obligation to shut down, coal-fired power plants are likely to be forced out of the market by the expected high CO_2 certificate prices, without receiving any compensation.

Calculations also show that Europe will have to phase out coal by 2030 to meet the 1.5°C target agreed at the Paris climate summit.[16] In addition, as described above, AET has already been obliged by the results of a referendum to give up its stake in the Lünen power plant by 2035 at the latest. Should AET succeed in its claim before the arbitration tribunal, it would be compensated for hypothetical revenues until 2053, which would never actually exist under any realistic scenario.

Furthermore, the question arises as to whether AET sufficiently took climate science into account when investing in the Trianel power plant. The power plant was commissioned more than 15 years after the adoption of the Kyoto Protocol. As early as 2007, long before construction of the Trianel power plant began, the Fourth Assessment Report of the Intergovernmental Panel on Climate Change described the need for rapid and substantial reductions in greenhouse gas emissions.

Two years after the power plant went into operation, the Paris Agreement was adopted, as a result of which Germany is required to significantly reduce its CO_2 emissions. In light of

The El Cerrejón opencast coal mine in Colombia has been criticised for its impact on the environment and human rights. It also supplies the Trianel power plant.

Foto: Tanenhaus, Flickr, CC BY 2.0

the evolving climate and energy policy frameworks, AET should not have invested in a fossil fuel project with such a long time horizon.

The fact that AET is now claiming that it assumed it would be able to operate the power plant until 2053, as stated in its submission to the arbitration tribunal, is a testament to its complete misunderstanding of climate science and global efforts to reduce greenhouse gas emissions. At the same time, it represents an attempt to retroactively get compensation for a bad fossil fuel investment by means of an arbitration claim – at the expense of the German public.

Corporate courts: A threat to the energy transition

One reason AET took this claim before an international arbitration tribunal could be the particularly investor-friendly conditions that characterise the proceedings (see Box 2). They offer unilateral rights to companies, while other factors such as environmental and climate protection generally are not acknowledged or considered relevant in the proceedings. Such tribunals are therefore unsuitable fora for negotiating key elements of the energy transition – such as, in the present case, the question of how the costs of the necessary phase-out of fossil fuels are distributed.

Furthermore, AET's arbitration case sets a dangerous precedent that could encourage other international companies to also challenge the German coal phase-out at an arbitration tribunal. A total of 15 coal-fired power plants currently in operation in Germany are majority-owned by foreign investors, including nine hard coal-fired power plants.[17] A success by AET in securing a payout could thus result in a series of further legal challenges against the coal phase-out.

Box 2: What makes arbitration tribunals so dangerous

Investment arbitration, as provided for in the Energy Charter Treaty and many other investment protection agreements, offers investors significant advantages as compared to ordinary courts:

- **Secrecy:** Arbitration proceedings are usually not public and allow almost no participation by third parties - such as affected residents or non-governmental organisations. In some cases, they are even kept completely secret, meaning that neither the suing investor nor the defendant state, nor the amount of compensation, are publicly known. In the AET case, at least some documents have been published, though crucial parts have been redacted.
- **Selection of arbitrators:** In an investment arbitration, the investor and the defendant state each select one arbitrator, and they must agree on the third arbitrator. This gives investors the opportunity to significantly influence the outcome of the proceedings. In addition, the arbitrators are often business-friendly arbitration lawyers who interpret disputed issues in favour of the investors.
- **Vague and broadly defined property rights:** The property rights on which investment claims are based are very vaguely defined in the ECT and most other investment protection agreements, and are often interpreted very broadly by arbitration tribunals. This makes it possible for investors to claim compensation in cases which regular courts would not entertain.
- **Amount of compensation:** Compensation in investment arbitration proceedings is often higher than in national courts. This is because lost profits are frequently compensated to an extent that would not be possible in national legal systems.
- **No appeal:** In arbitration proceedings, the possibilities for appeal are extremely limited. States can challenge rulings that are particularly favourable to investors only in exceptional cases, e.g. if outright corruption or bribery can be proven.
- **Worldwide enforceability:** Arbitration rulings are enforceable worldwide. If states lose cases and refuse to pay compensation, investors can confiscate the assets of the losing state in other countries.

This case thus has the potential to jeopardise the urgently needed implementation of the coal phase-out, especially during a time of tight public finances. A measure that is absolutely essential in terms of climate policy could potentially become so expensive that its implementation is delayed, or even worse, the whole phase-out becomes politically vulnerable. The signal this would send for the energy transition, in Germany and globally, would be devastating.

Beyond Germany such an arbitration case – even if it is ultimately unsuccessful – can cause collateral damage. It fuels doubts as to whether the tendering model chosen, which is considered particularly efficient from an economic perspective,[18] can serve as a model for other countries. Such uncertainty, and the possible paralysis of the energy transition that would result, would be fatal in the context of the accelerating climate crisis.

Moreover, the case could lead to states compensating fossil fuel investors more generously from the outset in order to minimise the risk of arbitration cases. Germany has already done this in its lignite phase-out: the federal government paid high compensation in return for coal companies waiving their right to sue.[19] As a result, money that is urgently needed for future-oriented spending is instead flowing into the coffers of fossil fuel investors.

AET's lawsuit is one of more than 1,400 investor-state disputes that have been filed against countries around the world. These disputes are notably dominated by companies in the oil, gas, energy and mining sectors – economic sectors that have particularly serious impacts on climate change, human rights and the environment.

A number of investor-state disputes have directly challenged climate policy measures. Particularly prominent among these were the ultimately unsuccessful proceedings brought by RWE and Uniper against the Dutch coal phase-out. Uniper's lawsuit was dropped after the nationalisation of the company – this was a condition for the bail-out by the German government. RWE gave up after German courts declared the proceedings inadmissible. The signal that would be sent by a successful and profitable AET case would therefore be all the more catastrophic.

Conclusion

AET's arbitration claim is an example of an investor demanding to be fully compensated from public coffers for the necessary closure of its fossil investments. This would result in taxpayers being forced to bear the business risk associated with investments in fossil fuel infrastructure in times of climate crisis. AET's attempt to obtain full compensation for an unrealistically long operating period shows how it is possible for companies to enrich themselves through arbitration claims on public funds.

AET's claim creates uncertainty about the phase-out of coal-fired power plants and, if successful, could significantly increase the costs of the ongoing and deeply necessary coal phase-out, even beyond the German context. As a public company, AET bears a special responsibility to act responsibly, and states that it takes pride in contributing to a climate-neutral energy system. The arbitration case against the German coal phase-out is in blatant contradiction to this, and AET should drop it immediately.

States should take this case as an impetus to immediately exit the investment protection system that makes it possible for companies to make profit from, and undermine, the fossil fuel phase-out. Germany and the EU have taken a first step by withdrawing from the Energy Charter Treaty. Switzerland should follow suit.

However, urgent action is also needed beyond the ECT. Germany and Switzerland have concluded more investment protection agreements than any other countries in the world. In both countries, it is therefore essential to launch initiatives to terminate existing agreements and prevent the conclusion of new ones. This is crucial to avoid future arbitration cases that undermine the energy transition and other key policy areas, and drain the public purse to increase profits for corporations.

Endnotes:

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